Reforming Universal Service Support in Rural Areas

Discussion paper prepared by

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Universal Service Policy Goals

- The goal of universal service is to provide all consumers with *access* to affordable telecommunications services.
  - Protecting consumers – not protecting carriers – should be the primary focus of universal service reform.
- Universal service reform should be carrier-agnostic:
  - by promoting *efficient* deployment of telecom facilities and services to rural areas;
  - by ensuring that rural consumers have access to affordable telecommunications services comparable to those available in urban areas; and
  - by establishing a level playing field for contributors and recipients of universal service.
- Control fund growth in a competitively neutral manner.

Establishing An Efficient USF Support Mechanism

Principles:

- Competitively and technologically neutral USF distributions and contributions
  - Portability (equal funding per line) establishes a level competitive playing field
  - Necessary to ensure that USF neither artificially promotes nor artificially restricts entry
- USF support based upon consumer needs, not carrier needs
  - Base support on forward-looking economic cost, not one carrier's legacy embedded cost
  - USF support available only where costs exceed a reasonable affordability benchmark

Wireless/Wireline competition helps advance Universal Service

- Consumers in rural as well as urban areas are choosing wireless for their basic and advanced telecom needs.
- Universal service is advanced by enabling consumers to use the technology of choice (*e.g.*, wireless).
- Universal service support is critical for wireless ETCs to construct and operate service in rural, high-cost areas.
- Wireless ETCs are currently serving areas unserved or underserved by wireline carriers, such as Indian reservations.
- The availability of a wireless network infrastructure supported by universal service stimulates economic development in rural areas.

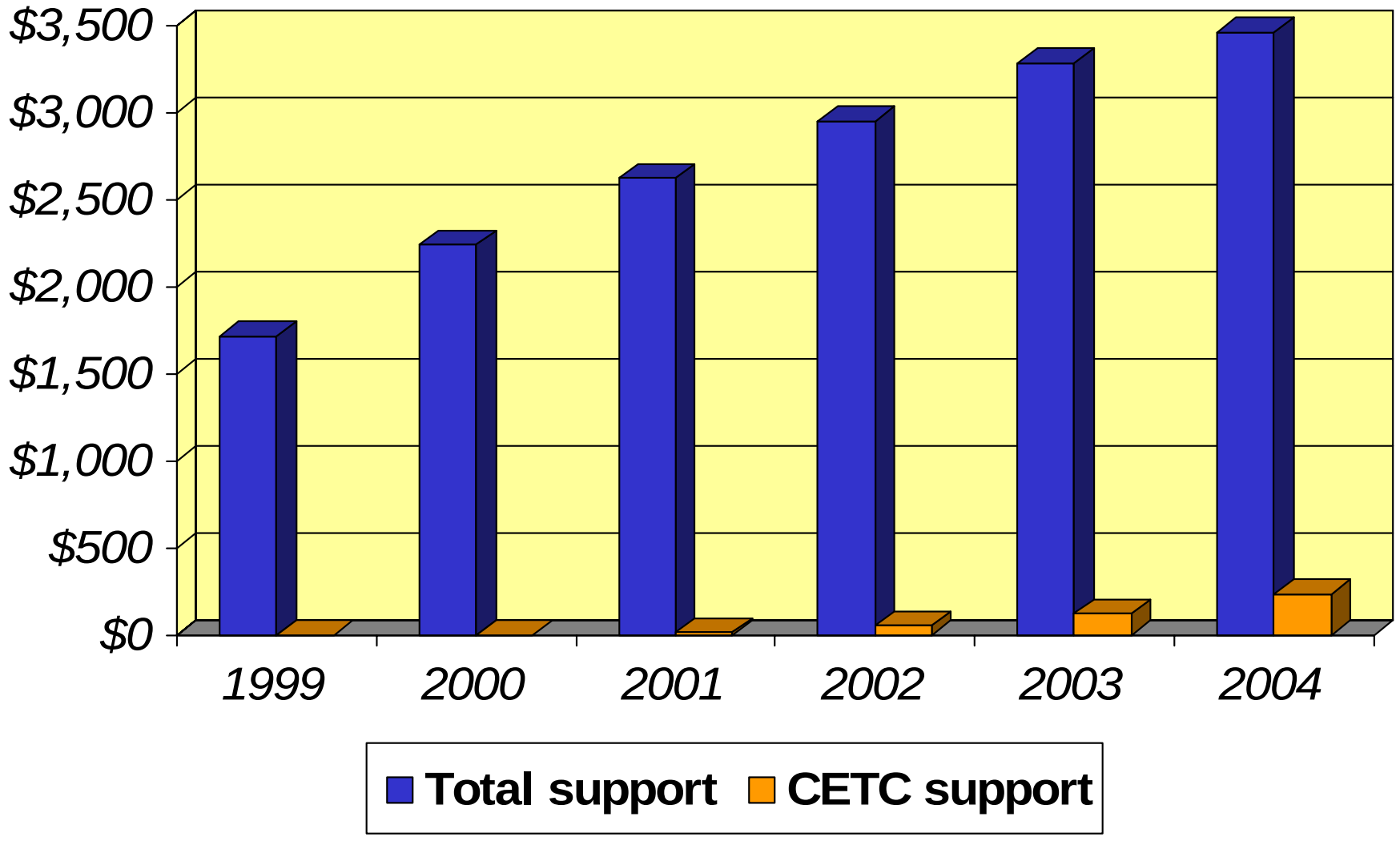
Consumers benefit from a competitive Universal Service System

- Consumers are realizing the benefits of a competitive universal service system as envisioned by the Telecom Act of 1996.
  - Examples:
    - Regent, North Dakota: wireless competition has forced incumbent carrier to be competitive and offer services that consumers need
    - Pine Ridge Reservation, South Dakota: more than 4000 tribal members with access to telephone service for the first time.
    - Rosebud Reservation, South Dakota: over 2000 tribal members sign up for service within one week of launch of service, spurring business, social, and economic development
    - Reese and Antelope Valleys, Nevada: over 50 residents without access to wireline telephone service, now have access to wireless service
    - Parker, South Dakota (see 1/20/05 USA Today article): consumers have access to wireless service for the first time
    - Texas: a large percentage of low-income consumers eligible for Lifeline discounts have access to wireless telephone service (wireline carriers are not meeting consumers' needs)
    - Texas: USF support has spurred economic development in rural Texas (see University of North Texas Economic Study)

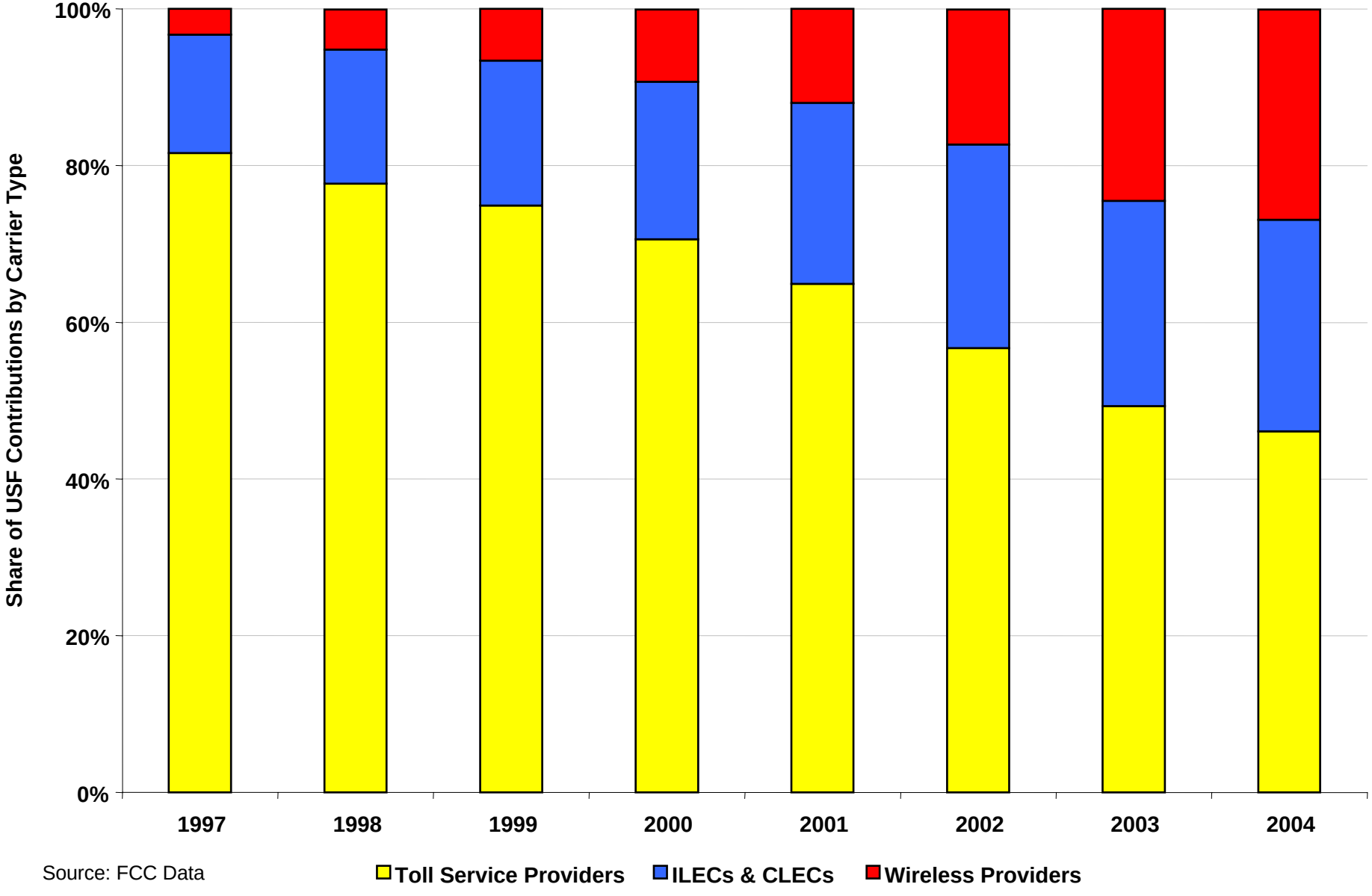
Wireless is a significant contributor to USF, but gets a small fraction of USF distributions

- ILECs receive over 15 times the High Cost Support that CETCs currently get.
  - Wireless carriers have been paying an increasing share of USF funding over time, yet draw only a small fraction of what they contribute.
  - ILECs continue to draw dramatically more than they contribute to the USF.
- Support to CETCs is *not* the main cause of USF growth!!

High Cost Support for CETCs is still less than 7 percent of total telecom industry High Cost Support

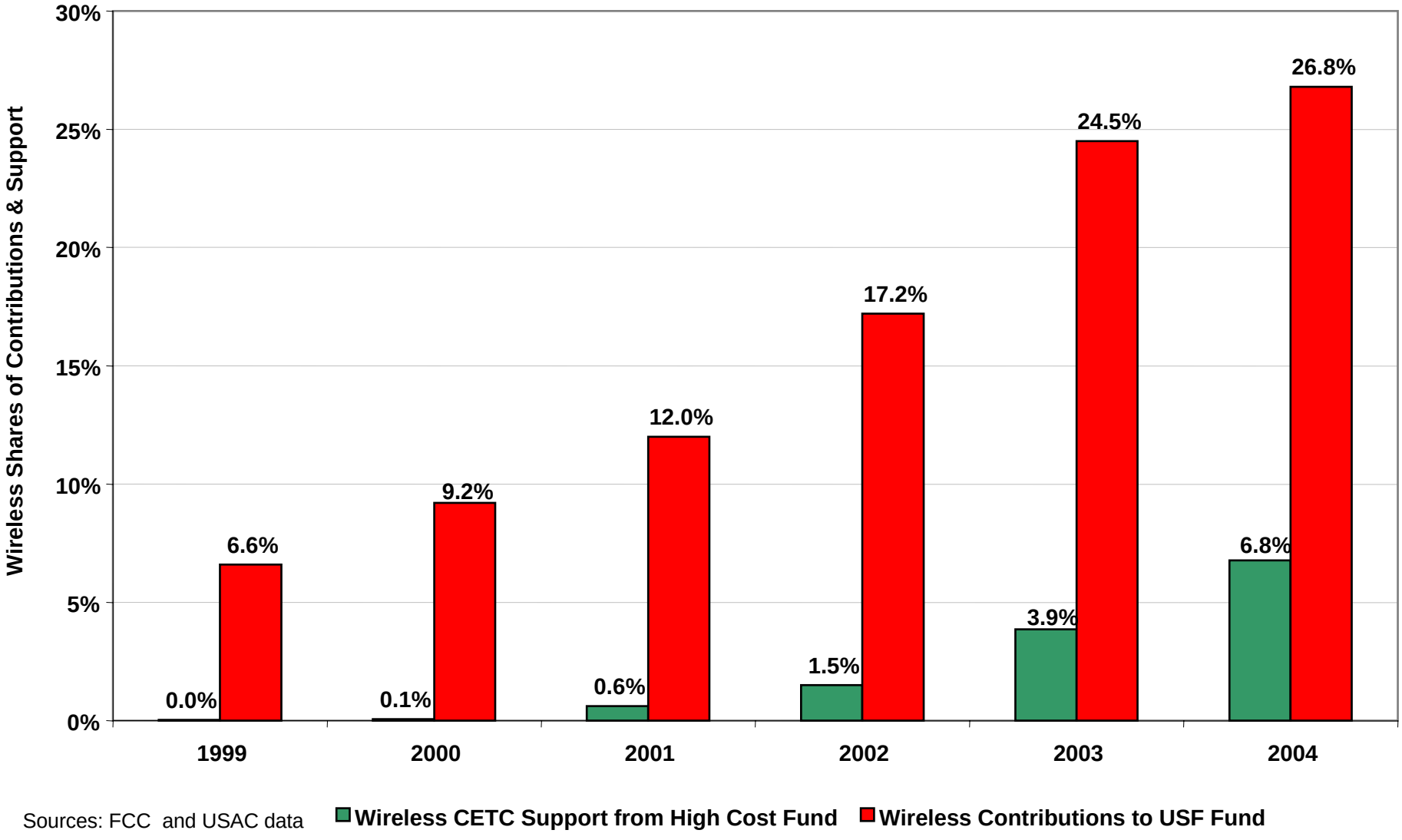


Wireless has been paying an increasing share of USF Funding over time



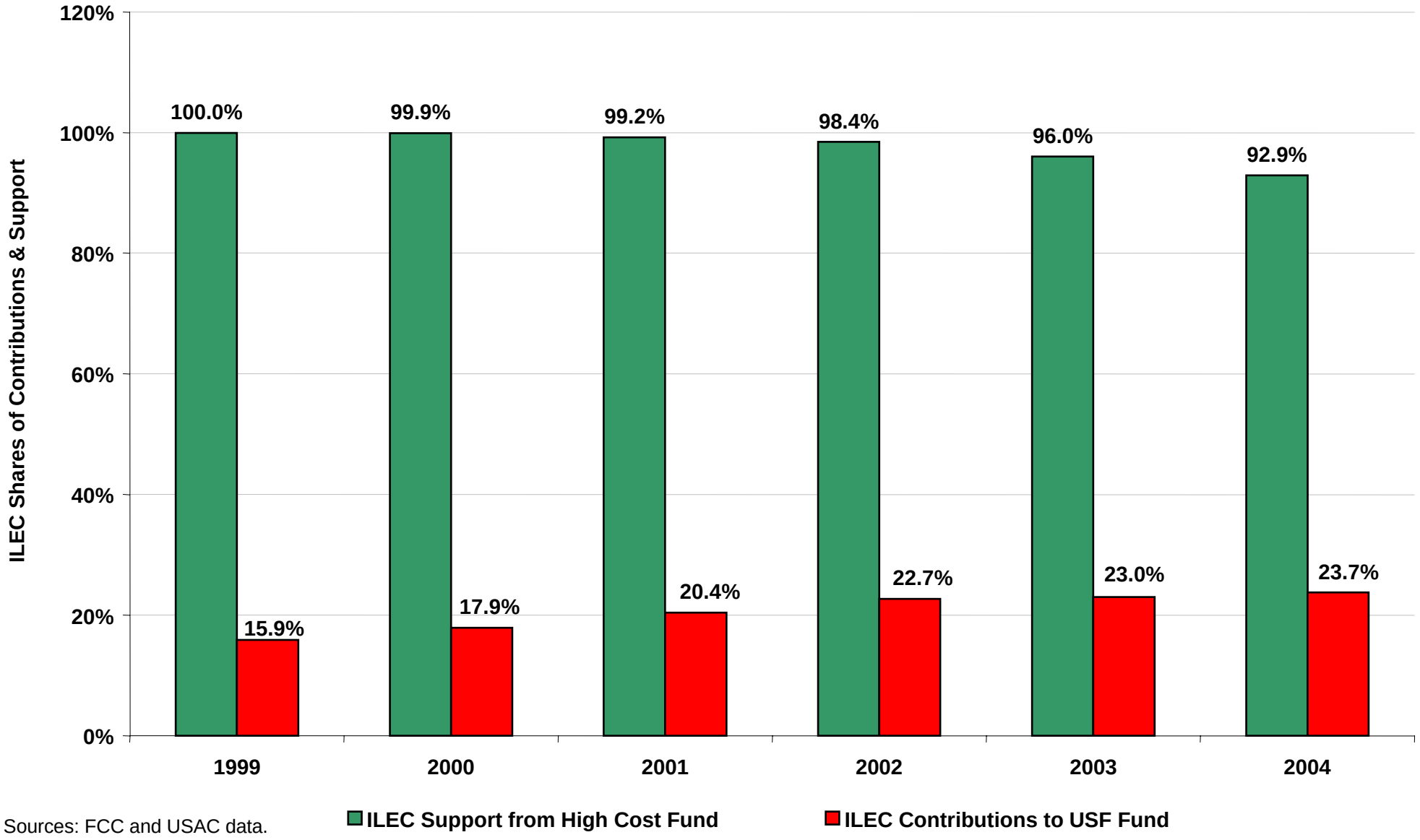
Source: FCC Data

… while Wireless draws much less than it contributes to Universal Service Funding



Sources: FCC and USAC data

And ILECs continue to draw dramatically more than they contribute to Universal Service Funding



Sources: FCC and USAC data.

A Unified USF Support Mechanism for All Carriers Serving Rural Areas (1)

- Establishing different funding systems for different sizes or types of carriers would make no sense:
  - Would violate competitive and technological neutrality, which the Act requires (see *Alenco* case)
  - Would undermine competition and harm consumers.

A Unified USF Support Mechanism for All Carriers Serving Rural Areas (2)

- Providing support to each carrier based on its "own" embedded costs would distort competition:
  - Giving larger amounts of USF to less efficient, more costly carriers, and less funding to more efficient competitors, would:
    - Penalize efficiency and create incentives for all carriers to operate as inefficiently as possible so as to maximize support
    - Interfere with competitive market dynamics, making it harder for more efficient carriers to compete effectively.

A Unified USF Support Mechanism for All Carriers Serving Rural Areas (3)

- All ETCs in an area should receive the *same* amount of support per-line.
  - Neither artificially encourages nor artificially discourages competitive entry.
  - Strengthens marketplace incentives to operate efficiently.
  - Strengthens incentives to compete for consumers by offering higher quality, lower prices, new technologies, and other benefits.

USF based on forward-looking costs

- Support should be based on the *forward-looking economic cost* of the most efficient technology.
  - FLEC is the most accurate and economically efficient cost measure, as the FCC, state PUCs, and courts have repeatedly recognized.
  - Would ensure that funding is adequate to support consumers' needs, but not excessive.
- Forward-looking costs are no less "REAL" or "ACTUAL" than embedded costs
  - The costs incurred 20 or more years ago to construct an ILEC network do not necessarily have anything to do with the real costs that carriers face *today*.

USF based on forward-looking costs

- Consider this example: Your home is destroyed by fire. How would you prefer to be compensated by the insurance company?
  - Based on the costs the builder incurred to construct the house 20 years ago? (Embedded costs)
  - Based on what it will actually cost to rebuild the same house today? (Forward-looking cost of existing facilities)
- Forward-looking costs are not necessarily *hypothetical.*
  - It's possible to estimate the *forward-looking* cost of constructing *existing* ILEC and CMRS networks.
  - Rather than using economic models, determine what it would cost *today* to build existing networks.

USF based on forward-looking costs

- It's also possible to develop appropriate economic models for rural areas.
  - Four years ago, the FCC *rejected* the RTF White Paper that argued the contrary.

RLECs are not entitled to continued funding based on embedded costs

- No legal right to embedded cost-based regulation – the relevant standard is “reasonable opportunity to recover investment”
- The arcane formulas in Parts 36, 54, and 69 of the FCC’s rules don’t necessarily bear any relationship to real-world costs.
- RLEC embedded costs have never been subject to a comprehensive independent audit.
  - FCC recently rejected NECA tariff because NECA could not substantiate booked costs.
  - There is good reason to think some RLECs’ costs may be overstated.

Retaining embedded cost USF support: *For sure, the losers lose*

- Businesses and consumers face economic consequences resulting from overstatement of Universal Service requirements under the present embedded cost regime
- Negative impacts of excessive USF surcharges upon telecommunications users across the country include:
  - imposing undue economic burden on many low-income households;
  - increasing firms' cost of doing business;
  - creating incentives for inefficient competitive choices.

Retaining embedded cost USF support: *Do the "winners" really win?*

- The downside risk of providing *too much* USF support must be considered.
  - ETI had estimated *$1-Billion* in fund enlargement due to RORR-induced inefficiencies
    - Inefficiencies deliver no additional benefits to rural America
    - Inefficiencies deliver no lower prices to rural consumers
    - Inefficiencies deliver no additional services to rural consumers
    - Inefficiencies distort actual economies of scale and scope
- Perpetuation of RLEC inefficiencies serves no public purpose